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DOW THEORY LETTERS

"THE MARKET AS INTERPRETED UNDER THE DOW THEORY"

RICHARD RUSSELL
125 EAST 93RD STREET
NEW YORK CITY 28

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A MARKET OF STOCKS? One of the most deceptive statements one hears these days is "this is a market of stocks, not averages--you can't buy the averages." A few stocks are then pointed out as laggard that have not moved with the trend of the market. This is supposed to be the final proof of the statement. Yet, before a bull market terminates, almost all stocks will make upward moves of varying degrees. It is well to remember that TIMING IS MORE IMPORTANT THAN SELECTION: poorly selected stocks will not perform as well as wisely selected stocks during a bull market, but the finest selections will (with few exceptions) collapse with a bear market. Most people spend far too much time on selection and trading in a fruitless attempt to catch the biggest moves in the most dynamic stocks. Given the beginning of a bull market, the average investor would do far better by buying a diversified list of investment grade, dividend-paying, growth stocks and riding them all the way through the bull market with as little trading as possible. Listen to the words of one of the greatest financial minds of the century, a man who was a confidante of the early empire builders, the founder of the Dow-Jones News Service, owner and first editor of the Wall Street Journal, and the creator of the Dow Theory, Charles H. Dow -- "The first thing for any operator to consider is the value of the stocks he proposes to trade. The second is to determine the direction of the main movement of prices." (the primary trend)....
"The great profits in stocks have almost invariably been made by people who saw the tendency of events clearly, and then bought large amounts of stock which they thought certain to get the results of a great increase of prosperity. Such stock had been held for months or years until profits accrued."....
"Stocks fluctuate together, but prices are controlled by values in the long run."....
"The operator should take a great stock of patience. He will see other stocks go up and his stocks stand still. He will see and hear daily that something else is making riches for traders, but he must shut his ears to these statements, even if they are right as far as fluctuations go. He must sit on his stock, which is intrinsically below value, until other people begin to observe that it is selling too low and begin to buy it."....
"The person who will wisely study values and market conditions and then exercise the patience of six men will be likely to make money in stocks."

INFLATION AND STOCKS. Much has been written about inflation's part in the recent market advance. Few are willing to accept the fact that stocks are bought on the hopes and expectations of future earnings. Many analysts are now ascribing the rise in stocks to inflation, over-speculation, shortage of stock, pressure of funds, everything but the basic reason--the coming improvement in business and the rising trend of corporate earning. I have never heard of an investor who bought rail stocks as an inflation hedge, yet the rails have risen 55% since last October, 1957, against 28% for the industrials. The reason--informed investors saw that the rails were selling below their line of values, they saw the business picture turning up, and consequently these investors bought the rails in anticipation of rising rail earnings. Inflation never entered the picture! "To know values," said Dow, "is to know the meaning of the market."

DOW THEORY. Last Monday (Oct. 27), after six days of steady decline, industrials broke through their previous reaction lows (made Oct. 15 at 536.14) and closed at 535. This move, although a strain on our nerves, was unaccompanied by any sign of weakness in the rails. In fact, on the downward "scare" penetration of the industrials, the rails refused even to go below a minor decline point (X - see chart). This writer was discouraged to learn that a few of his readers gave vent to their emotions and sold out at Tuesday's lows. "One of the shortest ways of going wrong," wrote Hamilton, "is to accept an indication of one average which has not been clearly confirmed by the other." The author would rather lose money while waiting to sell on the

implication of the averages than sell incorrectly through fear. Dow theorists are fond of pointing out that most of their mistakes were made when they trusted their emotions too much and the averages too little. The amazing strength shown by the rails all through the recent decline was further demonstrated when on Tuesday--following the first rally in six days--rails closed at a new high for the year! Although industrials barely inched up on the day, anyone who sold industrials after such a demonstration of rail power was disregarding one of the basic tenets of Dow's Theory--that a move of one average (in this case the former downward thrust of the industrials) is meaningless unless confirmed by a corresponding move in the other average. It was obvious, by this time, that the rails were not going to follow the weakness of the industrials. On Wednesday rails again went to a new high, and this time industrials surged with them for a fat advance of 5.84. This move was made on the highest volume since Oct. 17 which convinced this writer that the real money is tending to come out on the "buy" side, not the "sell" side. If the industrials now hurdle their previous high point (A - on chart) of 546.36, we will be in for a fine advance. A large amount of "weak" stock has been tossed into the ring on the recent decline and the market appears to be technically strong. The small buyer has been "shaken out" by the recent selling; he is again standing on the sidelines while the market surges up without him.

PSYCHOLOGY. It is interesting to note that had this latest weakness developed into a severe reaction, it would have been a well-advertised one indeed. We were all given five days of slow, obvious decline in which to sell stock, during which time we were all warned of an impending gigantic collapse. By all reports we were to lose all our profits in short order, and in fact--they were profits that we were not really entitled to have as the market was "ridiculously high" anyway. Dow Theorists know that this is not the sort of atmosphere that breeds great reactions. Really great reactions come deceptively, with little warning, at a time when the public has usually participated heavily. Before reactions, the majority of the analysts and the press are usually very bullish. Reactions are usually the result of an "overbought" market. But occasionally a depressing news event will cause a severe decline or reaction. In a market that is technically weak, almost any news will serve to touch off a reaction, although this same news would not faze a market that was technically strong (written Oct. 29 after the close.)

STOCKS I LIKE HERE: BETHLEHEM STEEL, U.S. STEEL, JONES & LOUGHLIN, U. S. RUBBER, GENERAL MOTORS, STONE & WEBSTER, ST. REGIS PAPER, DOW CHEMICAL, STANDARD OIL OF INDIANA, STANDARD OF JERSEY, STANDARD OF CALIFORNIA, PURE OIL, SINCLAIR, UNION OIL OF CALIFORNIA, ANACONDA, AMERICAN SMELTING, NORTH AMERICAN AVIATION, THOMPSON PRODUCTS, JOHNS MANVILLE.

(Thursday, Oct. 30). Today, on decreasing volume, the two averages diverged as rails eased slightly and industrials moved up a a fraction. One day's divergence is often meaningless, and this "pause" has frequently preceded a further rally. Based on the strong technical position of the market and the bullish volume indications I believe that shortly--perhaps after a bit more consolidation--industrials will go through their highs and a strong upmove will be underway.